



Quarterly Economic Update

March 24, 2008



MACROECONOMIC COMMENTARY

Monetary Policy

By Lance Lachney

At the time of our last meeting, Thomas Hoenig commented that the Federal Reserve was in a “wait-and-see mode” with regard to changes in monetary policy. The Federal Reserve Bank of Kansas City President also cast the only dissenting vote at the Halloween policy meeting (October 31) that lowered the federal funds rate by 25 basis points to 4.50%. In the FOMC statement, the committee noted that “economic growth was solid; however, it also stated that the expansion would likely slow in the near term due to the downturn within the housing sector. In summary though, the Fed concluded that “the upside risks to inflation roughly balance the downside risks to growth.” Remember, this move came on the heels of a 50bp ease made by the Federal Reserve at its September meeting. What we have witnessed over the last few months has clearly signaled a shift in the committee’s approach of “wait-and-see” to one of decisive action.

At the December FOMC meeting, policymakers once again decided to cut the federal funds rate by a quarter-point to 4.25%. Data gathered by the committee suggested that economic activity had decelerated significantly over the inter-meeting period. This action was taken in response to the softening in business and consumer spending as well as falling sentiment within the marketplace. The move was absolutely expected as concerns about credit availability and the sizable losses at financial institutions took hold. There were also worries about constraints within financials’ balance sheets and counterparty credit risk. Most of this stress was continuing evidence of the deterioration of mortgage-related assets. There were a few positive aspects during this time as a number of large financial institutions were able to raise substantial amounts of capital through preferred equity offerings and the infusion of cash from sovereign wealth funds. At the end of the day, the current monetary policy stance appeared restrictive in the eyes of the Fed as the downside risks to economic expansion had risen.

As the new calendar year rolled in, economic activity began to see a sharp deceleration. Conditions within the labor market started to noticeably deteriorate as payroll employment came to a standstill. During this time, unemployment had also risen to 5.0% from 4.7% in previous months. Headline inflation numbers had also ramped up considerably from the summer months due to the rapid rise in energy prices. As a result, future expectations within money market rates fell sharply reflecting the expected path of monetary policy over the coming months. This ultimately came to a head on Tuesday, January 22, one day after the celebration in honor of Martin Luther King. The previous Friday, Standard & Poor’s placed Ambac, a municipal bond guarantor that also insures structured products consisting of mortgage-related assets, on negative watch. The prospect of downgrades and the deterioration in the condition at ABK and related municipal bond insurers shook the market as a ratings move would lead to additional massive write-downs at large financial institutions. During the holiday, international equity markets were crushed with US equity futures pointing to a 5% drop in pre-market trading on Tuesday

morning. Upon recognition of the crisis of confidence within capital markets, the Federal Reserve lowered the federal funds rate by 75 bps before the equity market opened. This action came merely a week before the committee's regularly scheduled meeting at the end of January. Policymakers cited the tightening of credit for some businesses and households as reasons for the move, also stating that "appreciable downside risks to growth remain." A week later, Fed Chairman Ben Bernanke and his band of brothers were on the move again dropping the short-term lending rate to 3.00%. Dallas Fed President Richard Fisher cast the only dissenting vote on the concern that inflation expectations could become unanchored. In conjunction with this meeting, the Board of Governors also provided updated economic projections for the next three years. The substantive changes were related to the 2008 projections in which there was a 50 bp downward adjustment in GDP growth (1.3-2.0%) and an increase in the estimates for unemployment and inflation.

Since the end of January, the economic outlook has become more worrisome as consumer spending has slowed. A week and a half ago, the market was expecting a 50 bp cut for today's meeting with a small chance of a 75 bp move. On March 11, the Federal Reserve announced an expansion to its securities lending program by introducing a new Term Securities Lending Facility (TSLF). Under this program, the Fed will lend up to \$200 billion of treasury securities to primary dealers for a term of 28 days in exchange for a pledge of collateral consisting of agency debt, agency residential mortgage backed securities, and non-agency AAA/Aaa-rated MBS. The intervention was to "promote liquidity" and "foster the functioning" of financial markets. The advantage of this program is that it offers non-bank dealers access to the same kind of collateral awarded to banks under the Term Auction Facility (TAF). In essence, the Fed is taking the opposite side of the prevailing market trade at the moment (flight to safety), which is selling mortgage backed securities and buying treasuries.

The auctions for the new Term Securities Lending Facility (TSLF) were set to begin on March 27. On the surface, it seems it came "too little, too late" for Bear Stearns (BSC). The firm who had been labeled as the originator of the subprime crisis last summer had run into major funding problems. As many broker-dealers use the repo market to finance its inventory and positions, BSC found that no one wanted to accept the perceived counterparty risk that it carried. In a scene reminiscent of the gathering outside Bailey Building and Loan in *"It's a Wonderful Life"*, trading partners began making margin calls resulting in a dramatic loss of cash reserves. In order to stabilize the meltdown in an orderly fashion, the Fed allowed Bear access to funding through the discount window through JP Morgan. It seems that liquidity, for the most part, has become a state of mind. For those firms that rely on overnight funding, perception is reality. Over the weekend with virtually no options available, management accepted JP Morgan's \$236 million offer (\$2 /share) for the company. The agreed upon sales price was roughly 90% lower than BSC's closing price on Friday. The Federal Reserve provided a \$30 billion backstop to complete the transaction that will be secured by the mostly illiquid assets that will be inherited. In an ironic twist, it was BSC who refused to participate with a dozen others ten years ago to provide a \$3.6 billion bailout of Long Term Capital Management. The view seems to be that BSC wasn't "too big to fail" in the eyes of the Federal Reserve, but that the failure to make good on contracts would severely dislocate markets, especially the repo market, which is at the heart of the credit market.

Unfortunately for the Fed, the weekend had just begun. On Sunday, it granted the Federal Reserve Bank of New York the authority to establish a Primary Dealer Credit Facility (PDCF). This secured facility will allow discount window borrowing for primary dealers that was not available to them through the Term Auction Facility (TAF) that was established in December. These loans will provide overnight funding that may be collateralized by a broad range of investment grade securities. This places the current environment in “unchartered waters” as policymakers invoked a clause within the Federal Reserve Act to waive the prohibition on loans to non-bank institutions. With the massive deleveraging (hoarding of cash) taking place, the Fed believed the move was necessary as the traditional tool of cutting rates in isolation was doing little to inspire the willingness to lend.

At its regularly scheduled meeting today, the Federal Reserve lowered both the fed funds and discount rate 75 bps. The market for the most part was expecting a 100 bp move using the fed fund futures as a predictor. Policymakers may have opted for 75 bps for several reasons – somewhat tame inflation numbers last week, two dissenting votes (Fisher/Plosser), discount rate requests came from regional banks that have been historically dovish, and to see the effects of the new facility program. Of particular note in the statement was the inclusion of rising inflation expectations, despite its belief that inflation will moderate in the foreseeable future. Within the growth discussion of the statement, it reads that “credit conditions and the deepening of the housing contraction are likely to weigh on economic growth over the next few quarters.” This seems to translate that a quick turnaround in which the FOMC raises rates is not in the cards for a long time. The market reacted positively today with equities up approximately 4% on the back of better than expected numbers out of the brokers. In all honesty, I am not sure what to make of it. While relieved that policymakers are taking bold initiatives to provide market liquidity when needed, I am also disturbed as to how the market became so unstable that these actions are warranted. To steal a line from George Bailey- “Clarence! Clarence! Help me, Clarence!”

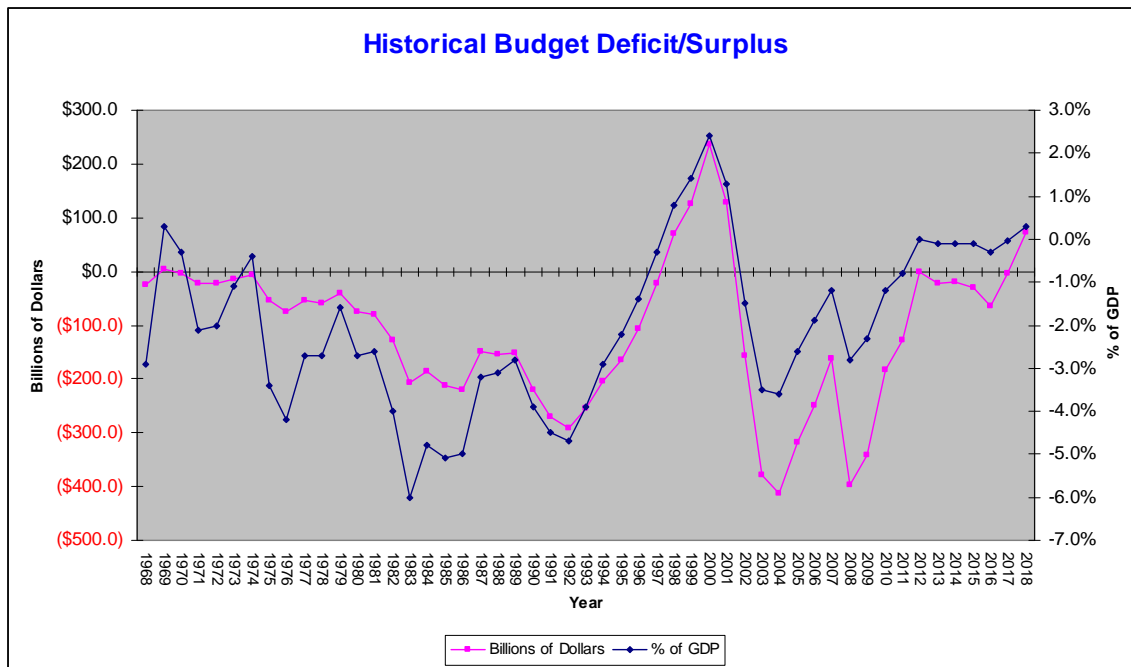
Fiscal Policy

By Bobby Long

According to the US Department of Treasury, the federal budget deficit in the first quarter of fiscal year 2008 was around \$106 billion. This represents a \$26 billion change from the \$80 billion deficit recorded in the first quarter of fiscal year 2007. Total receipts increased 5.6% from the same period of the prior year to \$606 billion. Notable increases from the prior period were a 7.3% increase from individual income receipts and an 8.1% increase from social insurance receipts. Corporate income receipts were 5% lower than the same period of the prior year. Total outlays increased 8.5% from the same period of the prior year to \$712 billion. Notable increases from the prior period were a 17.1% increase from interest paid on public debt, a 10.6% increase from Medicaid outlays, a 7.9% increase from defense/military outlays, and a 5.8% increase from Social Security benefits. A deficit of \$56 billion and \$98 billion was recorded for the months of October and November, while a surplus of \$48 billion was recorded for December.

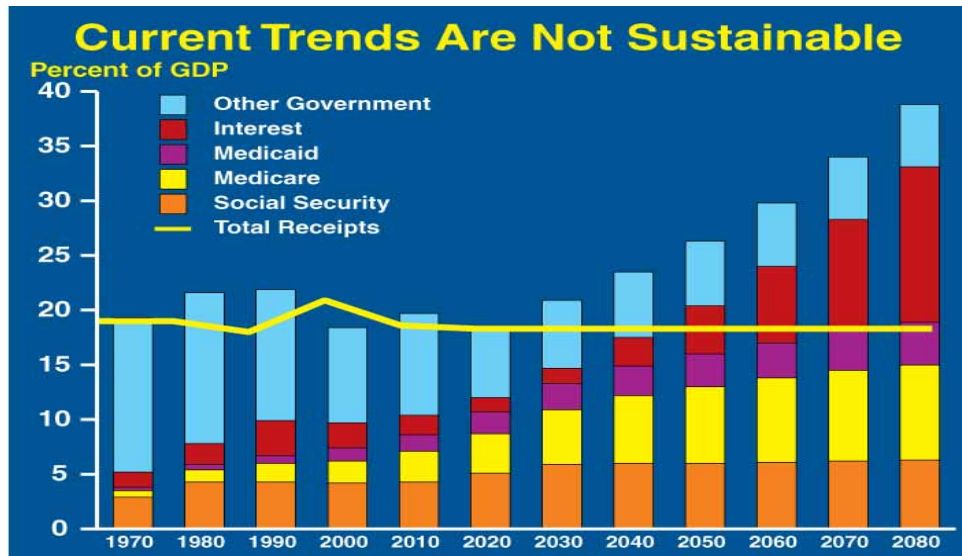
In the face of a significant slowing of the economy, deficits are expected to increase largely due to a decline in corporate income tax receipts. In an attempt to stimulate the economy, Congress passed the Economic Stimulus Act of 2008 on February 7, 2008. The stimulus package provides tax rebates to individuals and special depreciation allowances to businesses. The Congressional Budget Office (CBO) estimates the act will have the effect of increasing budget deficits by \$152 billion in 2008 and by the net amount of \$124 billion over the 2008-2018 period. These estimates include decreased revenues by \$114 billion in 2008 and by a net amount of \$82 billion over the 2008-2018 period due to rebates for individuals and business tax deductions. Spending is estimated to increase by \$38 billion in 2008 and \$42 billion over the 2008-2009 period primarily due to the cost of rebates for individuals. Hopefully, this stimulus will have some impact by encouraging spending throughout the economy and providing support for tax revenues. However, the effects could be muted due to the weak financial position many individuals are currently facing and the growing concerns about the strength of the economy. Many individuals indicate they would use any tax rebates to pay down existing debt or increase savings, which would not provide the same boost to the economy and tax revenues as discretionary spending.

The CBO has revised their budget projections based on the current state of the economy and the economic stimulus package. They now estimate the federal government will realize a budget deficit of \$396 billion in 2008 and \$342 billion in 2009. These deficits would represent 2.8% and 2.3% of gross domestic product (GDP), as compared to the 2007 deficit of 1.2% of GDP. The CBO estimates government debt held by the public will rise to 38% and 39% of GDP in 2008 and 2009, compared to 36.8% of GDP in 2007. The chart below shows the historical deficit/surplus as a percentage of GDP and includes the CBO's projections through 2018.



The CBO expects the budget deficit to increase in 2008 and then decline gradually through 2012. Between 2012 and 2018, the budget is projected to remain close to balanced with a small deficit or surplus. These projections are based on current and proposed spending levels and anticipate tax revenues under the current economic environment and tax laws in place. A number of factors could cause the actual outcome to differ significantly from these projections. With an uncertain economy and an election year, we are likely to see changes to both tax laws and spending levels after the election season unfolds.

Long term the budget continues to face significant challenges. According to the President's 2009 Budget and Fiscal Outlook, long-term projections of all government programs and interest on government debt show that the deficit could exceed 20% of GDP by 2080 if receipts are held at the 40-year historical average of 18.3% of GDP. The chart on the following page from the President's 2009 Budget shows the unsustainable growth trends under current programs.



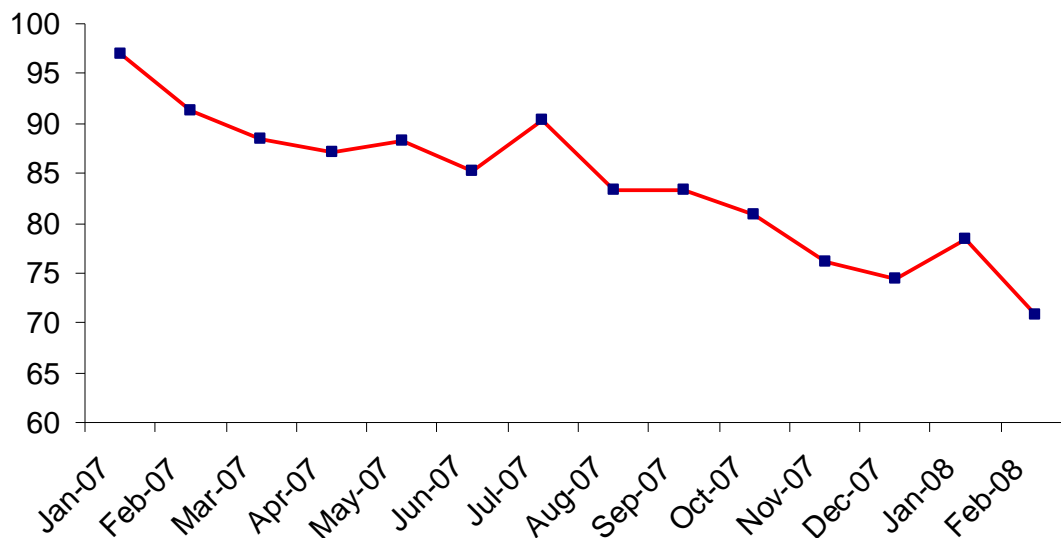
The three largest government entitlement programs shown above are growing at rates that are not reasonably sustainable, in large part due to rising healthcare costs and the aging population. Without changes to these programs, the expenses will become a larger share of GDP over time and the interest expense on government debt used to fund these programs will grow as well. At some point in the future, these programs and the growth in their spending levels will have to be addressed and tough decisions will have to be made to maintain a healthy fiscal balance.

Economic Outlook

By Kevin Gamble

The American household squeeze is certainly upon us. The consumer is getting hit from all sides in an unprecedented fashion. The pressures include a national housing recession, falling stock prices, rising energy costs, rising food costs and a weakening job market. The combination of all these factors has led to a 27% decrease in the University of Michigan's consumer confidence survey from January of 2007 (96.9) to February of 2008 (70.8).

Chart 1: University of Michigan Consumer Confidence Survey



Source: Reuters/University of Michigan

While the “talking heads” continue to debate as to whether or not we are in a recession, this technical definition has very little relevance for the average American consumer who is facing these major headwinds. What is clear is that the consumption component of GDP (roughly 70% of U.S. GDP) is likely to be very challenged in the foreseeable future.

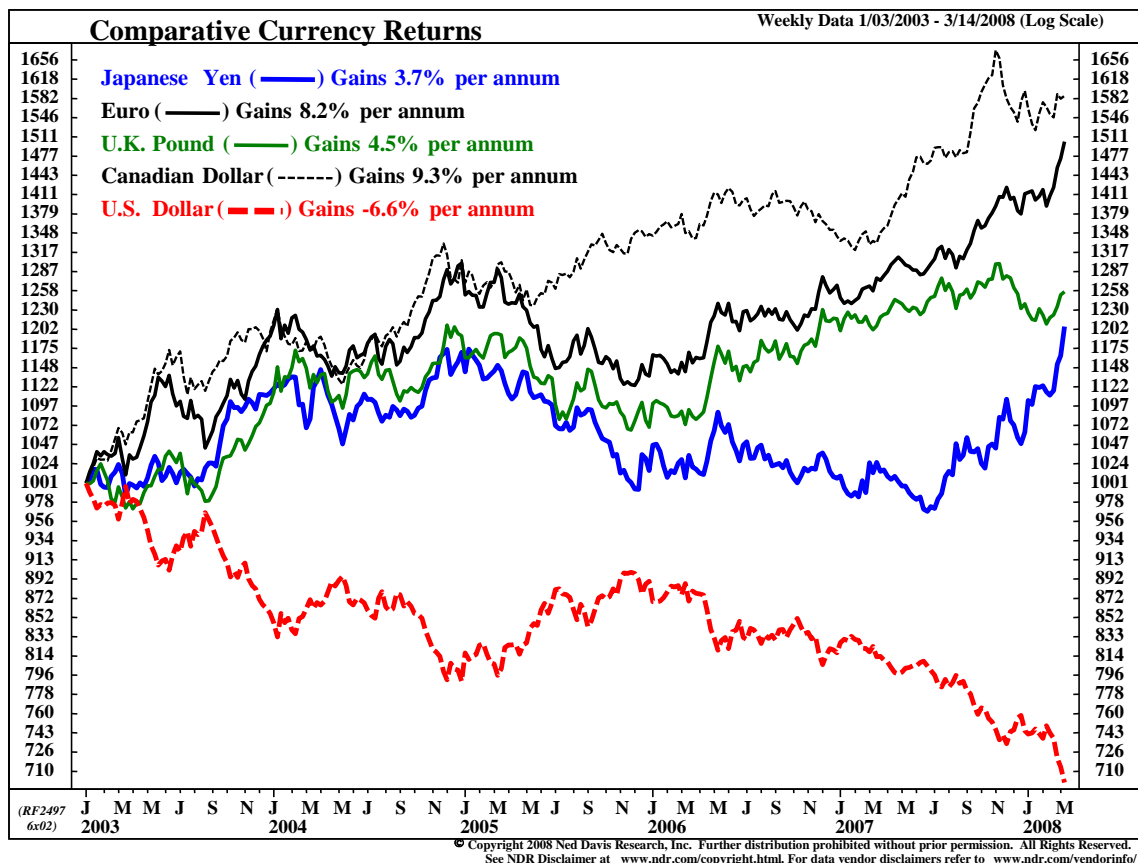
To offset the declining consumption component of GDP, the government is doing their very best to keep things afloat by providing a one-time tax rebate to American families earning less than \$150,000 in annual income. While this certainly does not hurt things at the margin, it is not likely to be a solution to the problem, but rather a band-aid which provides a temporary stimulus to the economy to hopefully get us (or more importantly them) through the election.

In addition to a one-time tax rebate, the U.S. government continues to spend a tremendous amount of money on our military efforts in Iraq and Afghanistan. Recent estimates put this spending at roughly \$15 billion a month. While this spending is a support to the economy and thus GDP for as long as we continue to

spend it, it should be noted that we are not in a great situation fiscally to be spending this money given the fact we have a large and ever growing national debt.

The component of GDP which is most likely to do well in the current environment is net exports. This is due in large part to the fact the U.S. dollar continues to decline versus a basket of major currencies making our products cheaper to foreign buyers. The table below takes a look at the relative decline of the dollar.

Chart 2: Value of the U.S. Dollar versus Major Currencies



Source: Ned Davis Research

Labor is the key!

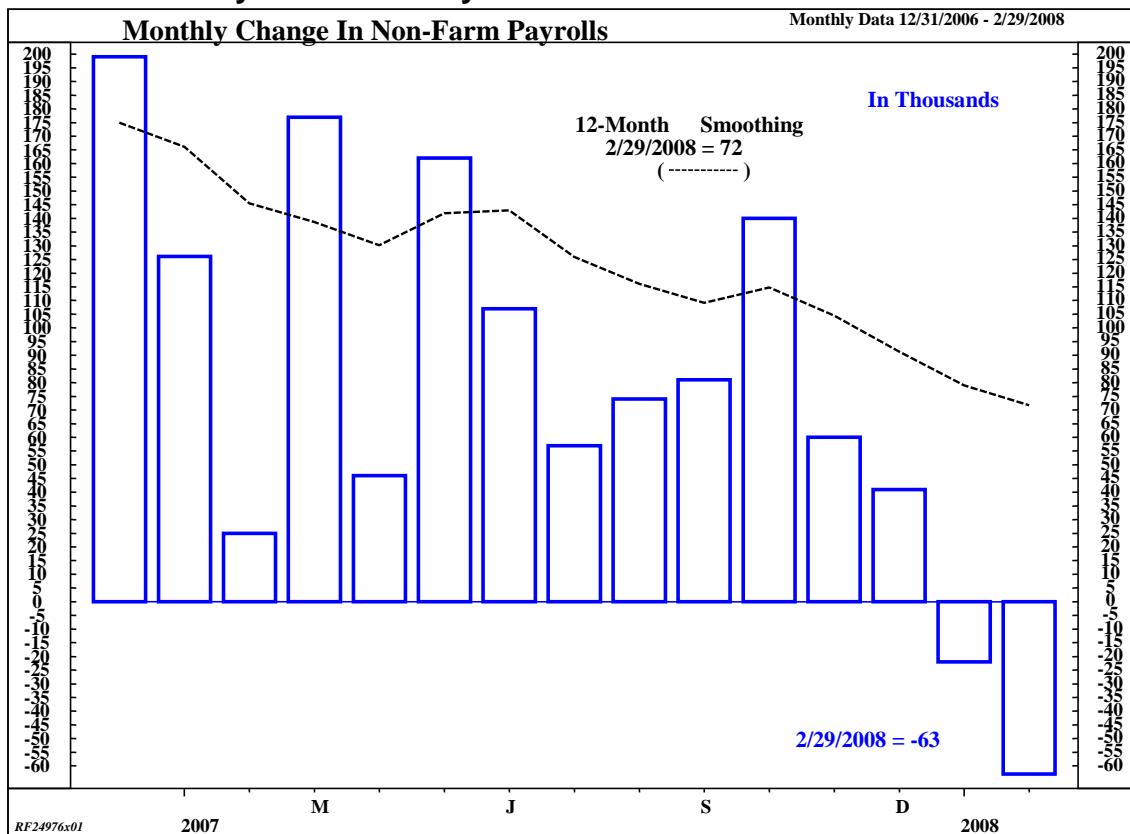
The labor market is the key variable in this economic downturn. It is absolutely imperative for the labor market to remain intact for this economy to have a chance to grow. We are seeing delinquencies across all credit products from mortgages to credit cards, indicating financial stress on the household. It is quite clear that if folks cannot service their debt when they have a job, they certainly will not be able to if they do not. Thus the necessity we have is to keep people employed. Unfortunately, recent evidence and data suggest the labor market is deteriorating.

Here are examples from the most recent quarter:

- Yahoo! announced they are cutting 1,000 jobs or 8% of the work force
- Home Depot announced they are cutting 10% of the work force at their Atlanta headquarters
- Ann Taylor announced they are closing 117 stores and laying off 13% of the workers at their headquarters not to mention the workers losing their jobs at the 117 stores
- Eddie Bauer announced they plan to cut 123 jobs or 16% of staff
- Wyeth announced they are cutting 4% to 6% of their workforce
- Dell announced they are cutting 1,200 jobs in US and Canada
- Chrysler announced they are shutting down 4 plants
- ADS announced they are cutting 251 jobs
- Selective Insurance announced they are cutting 80 jobs
- Charming Shoppes announced they are cutting 200 jobs and shutting down 115 stores
- Harman announced they are shutting 2 plants and cutting 500 jobs
- Lehman Brothers announced they are reducing their headcount by 5% affecting 1,400 jobs

What is clear to see is that job cuts are hitting all areas of the economy from healthcare to retail to financials. The chart below takes a look at the trends in monthly non-farm US payroll figures:

Chart 3: Monthly Non-Farm Payrolls

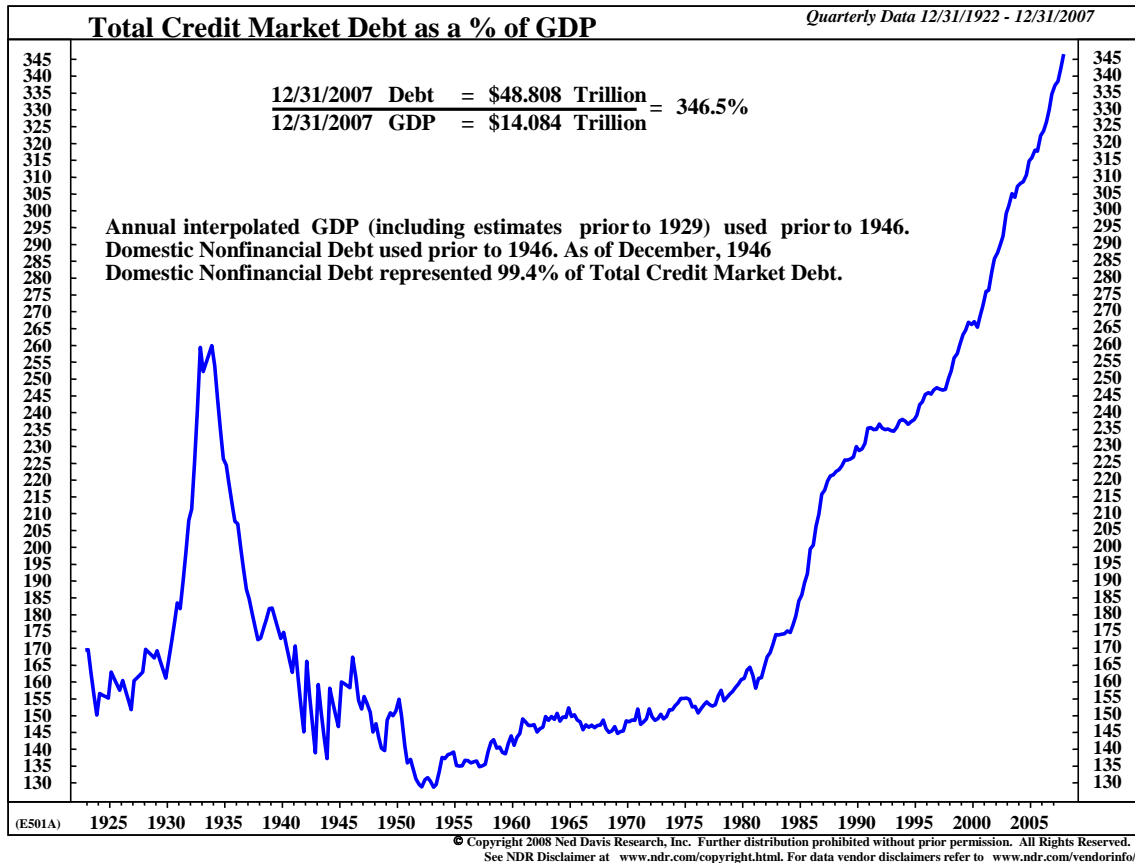


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Source: Ned Davis Research

What is the primary source of our problems? Too much debt! The following chart takes a look at the explosion in credit market debt as a percentage of GDP.

Chart 4: Total Credit Market Debt as a % of GDP



Source: Ned Davis Research

Could we be headed into the “Greater” Depression?

There are quite a few economic similarities between where we are today and where we were at the beginning of the Great Depression in the early 1930s in the United States. While there are certainly some differences, it would be foolish for someone to ignore the similarities. These similarities include:

- a) A deflating credit bubble
- b) Negligible savings rate among US consumers
- c) Falling stock prices
- d) Real estate deflation
- e) Rapidly rising unemployment at the margin originating from fairly full employment
- f) Low interest rates (this is generally perceived as a good thing, but is nonetheless a similarity)
- g) A declining US dollar

- h) Healthy corporate balance sheets (this is generally perceived as a good thing, but is nonetheless a similarity)
- i) Large gap between the “haves” and “have nots” with a declining middle class
- j) Declining influence of organized labor
- k) Large gains in productivity not flowing through to labor

Hopefully for all involved today's situation does not play out like the 1930s, but the similarities need to be mentioned. It is also important to acknowledge that interest rates were low and corporate balance sheets were generally healthy as we moved into the Great Depression. While these are generally positive factors, they certainly do not preclude us from heading into tough economic times.

On the positive side, Chairman Bernanke has studied the Great Depression in great detail and is unlikely to repeat the Federal Reserve mistakes of the past, namely allowing the monetary base to shrink in a time of economic contraction. Examples of his commitment to expanding the monetary base can be seen in his aggressive easing of the federal funds rate in addition to aggressive use of term-auction facilities and the discount window. On March 11, 2008, the Fed agreed to lend up to \$200 billion in exchange for mortgage-backed securities in perhaps its most significant step to shore up the mortgage and credit markets.

In addition to an aggressive Fed, one can argue that markets are much more global than they were in the 1930s and the economic strength and growth potential of emerging nations such as China and Brazil will help to support the United States during a potential domestic slowdown. It is true that many U.S. corporations are deriving a greater percentage of their operating income from overseas markets which should help offset domestic weakness. While this should help support the U.S. equity market somewhat, it does not really change the bleak outlook for the American worker.

RSA PORTFOLIO STRATEGY

Interest Rates and Fixed Income Strategy

By Julie Barranco

Volatility has continued its presence in the bond market since our last meeting. Declining Treasury yields and a steepening yield curve have been dominant traits over the past quarter just as they were in the previous quarter. Negative headlines out of the housing and mortgage sector have continued and fears of a recession have led to persistent disruptions in the credit sector. The Fed has responded by cutting the Fed Funds rate down to 3% by the end of January and an additional 75 basis point cut at the March 18 meeting.

December started poorly as the 25 basis point Fed cut disappointed the market, which had expected a 50 basis point move. However, subsequent steps taken by the Fed and other central banks helped to relieve some of the short-term funding pressures in the market. Additionally, financial firms such as Fannie Mae, Freddie Mac, Citigroup and Wachovia - who had all announced subprime mortgage related writedowns - were able to raise needed capital in the preferred securities markets. These were positive developments that provided some temporary support to the markets. As we moved into January, the rollercoaster ride continued as we saw weak economic data releases, a 75 basis point inter-meeting cut followed by a 50 basis point cut at the scheduled Fed meeting, more financial sector writedowns and the beginning of the downgrades on some of the AAA-rated monolines (Ambac, MBIA, FGIC, etc.). By underwriting other issuer's bonds, the monoline insurers lend their credit rating to these other issuers. If they are downgraded, so are the issues they have underwritten. Presently the three main monoline insurers have managed to retain their AAA ratings with Moody's and S&P, but with the understanding that some restructuring of the business will have to be done. This could include separating the municipal and structured credit businesses, and/or raising capital levels. Given the extent of the financial system's exposure to the monoline sector, one can see that a large number of investors have a vested interest in preserving the monoline's AAA model and downgrades would have a far reaching impact on the financial markets.

In February, more negative headlines about the economy and the financial sector added to investor concerns. The latest segment to be affected was the auction-rate bond market. Auction-rate securities are long-term bonds whose interest rates reset every 7, 28 or 35 days at auctions run by dealers such as Merrill Lynch or Banc of America. Typical issuers are municipal entities who rely on these dealers or banks to be buyers when bidders cannot be found at their auctions. If no buyers are found, the auction fails and the rate resets to a level defined in the issuer's original offering memorandum, typically much higher than a market determined rate would have been. As investor confidence in the insurers backing these deals has waned and banks have avoided tying up more capital, numerous auctions have failed. This has led to further liquidity constraints in the market.

This new round of disruption in the markets led to further spread widening not only in the financial sector, but the credit markets as a whole. Through February month end, the high grade index has underperformed for the last four consecutive months and seven of the last nine months.

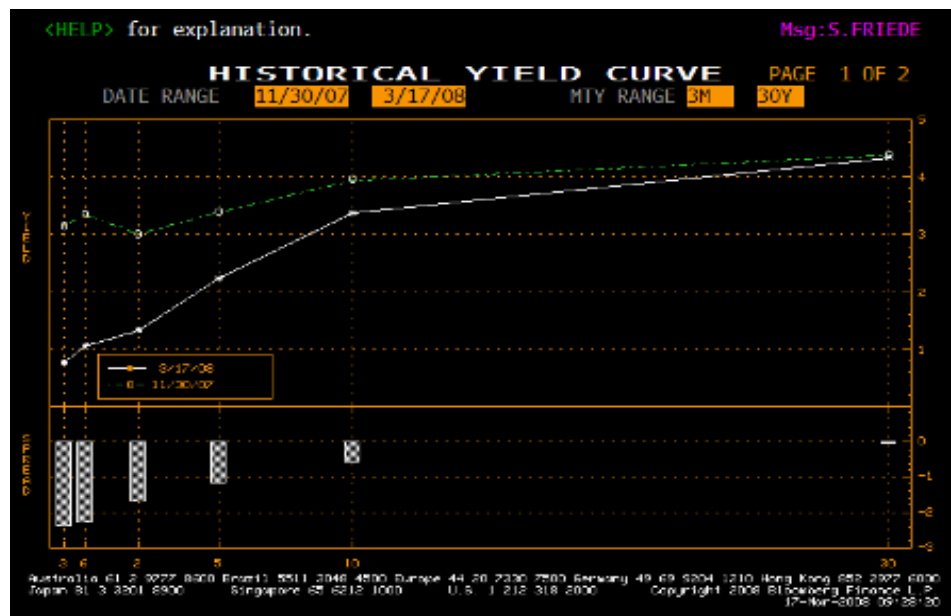
The chart below depicts monthly excess return since June 2007 and highlights the severe underperformance of the financial sector over this time period.

Monthly Excess Return in 2007-08 Credit Crunch

	U.S. Corporate Master High Grade Index	Aggregate Finance	Aggregate Industrials	Aggregate High Yield
June-07	(0.28)	(0.33)	(0.24)	(1.71)
July-07	(1.64)	(1.62)	(1.69)	(4.85)
August-07	(0.78)	(1.23)	(0.38)	(0.62)
September-07	0.05	0.08	0.05	1.84
October-07	0.16	(0.20)	0.44	(0.16)
November-07	(2.66)	(3.11)	(2.29)	(5.29)
December-07	(0.09)	(0.03)	(0.13)	0.10
January-08	(1.63)	(1.31)	(1.96)	(4.28)
February-08	(1.10)	(1.29)	(1.02)	(2.68)

Source: ML Indices

The chart below details the changes in the yield curve since our last meeting and clearly depicts the continuing decline in yields, particularly on the short end of the curve. This has led to further steepening of the curve as the 2-year Treasury note now yields around 1.55% while the 10-year Treasury note yields 3.40%, for a differential of 185 basis points. Despite the 200 basis point cut in rates that the Fed delivered in January through March, Fed Funds futures currently still predict a better than 75% chance of an additional 50 basis point cut in April.



Source: Bloomberg

Treasuries have continued to be the best performing sector over the past few months as the flight to quality theme has continued. While there has been the occasional spread rally on positive news in the credit sectors, these rallies have not been sustainable as the sub-prime markets and related writedowns, soaring oil prices, a weaker dollar and concerns about the economy's health all contributed to investor dismay. While the agency and

mortgage sectors initially held in fairly well, we have seen significant spread widening in these sectors over the past several weeks as concerns about additional write-downs at Fannie Mae and Freddie Mac have risen. These entities buy and hold mortgages as well as issue and sell guaranteed mortgage backed securities. In February and March, the mortgage sector saw unprecedented spread widening as the housing sector continued to weaken and typical buyers of these securities remained on the sidelines due to their own capital constraints. High grade corporate bond spreads continued to widen, particularly in the financial sector. As we have discussed before, this sector has been hit the hardest as the broker/dealers and banks have been hurt by their exposure to sub-prime mortgages and the subsequent writedowns taken. High yield corporate bonds have continued to vastly underperform the investment grade market as investors have been extremely wary of riskier credits as well as rising default rates.

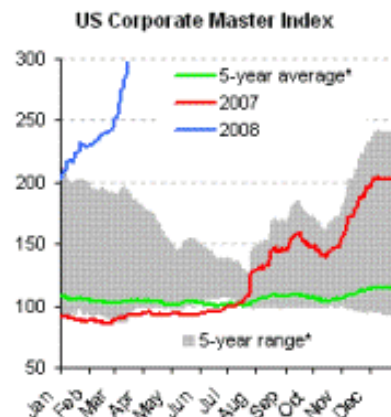
As was the case last quarter, the main concern within the bond markets is the turmoil in the mortgage markets and fears of a credit crunch. Wider spreads and increased volatility are expected to continue in the coming months, particularly in the financial services sector. The charts below depict the spread changes within the high grade corporate sector as a whole and the Financial Services sector over the last five years; corporate spreads in general are currently well above their 5-year average levels and Financial Service spread levels are at the widest levels since late 2002.



Source: ML Indices (C0P0, CFBR, CFFI, CFIS, CIRE) CreditSights

	Mar 14 2008	Change (bp)		
		Week	Month-to-date	Year-to-date
Banks	351	26	63	107
Brokers	396	72	125	185
Finance & Investment	313	32	58	111
Insurance	294	13	30	93
REITs	444	9	55	186

Source : CreditSights



* 2003 - 2007

Source: ML Indices (C0A0), CreditSights

	Mar 14 2008	Change (bp)		
		Week	Month-to-date	Year-to-date
High Grade	297	22	45	94
Financials	344	35	69	122
Non-Financials	266	13	27	76

With these issues in mind, it has been difficult to find attractive opportunities on the purchase or sale side. We have added very selectively to our corporate weighting; however, it is only slightly higher than last quarter. Issues added were higher quality names in the consumer, telecommunications, oil and basic sectors. This continues our strategy over the last few quarters of buying larger, more liquid

issuers that should provide more stable performance during downturns in the credit markets. Most of our purchases have been in the short to intermediate part of the curve so as to keep duration neutral to slightly short within the corporate sector. Other than a few of the larger broker/dealers, the corporate bond portfolio has been largely insulated from the poorest performing industries as we have little to no exposure in these companies.

During January and early February, we had several of our agency notes called as the call options moved into the money while interest rates decreased further. We also sold a couple of issues that were callable within a few months as we were able to get a slight premium over par value. While we did not reinvest all the proceeds from these calls and sales back into the agency sector, we did reinvest a portion, mainly in bullet short and intermediate bullet issues that would benefit from further steepening of the yield curve. The duration of the agency portfolio has been somewhat short versus that of the index, which has been beneficial to the portfolio as agency spreads have widened over the past several weeks.

We have recently started to selectively add some agency mortgage backed security exposure to the portfolio. As mentioned earlier, this sector has underperformed all other investment grade sectors by a wide margin over the past couple of months in the wake of liquidity problems within the financial sector and increased volatility in the marketplace. Spreads in this sector hit 20-year wides within the last few weeks and yield significantly more than current agency notes. In addition, they have collateral backing the notes. We think there is definite value in some of the more seasoned issues with loans that originated before the peak of the housing bubble. Prepayment risk should be somewhat mitigated as incentives to refinance are reduced. As we can find these seasoned issues that are geographically diversified and have a good payment history, we will look to add to this sector as we feel spreads will tighten back in and this sector will perform well as the credit crunch begins to subside.

Domestic Equity Strategy

By Keith Buchanan

The equity markets have been in a tailspin since the S&P 500 hit an all-time high on October 11 of last year. Up until then, the market had shrugged off the initial declines in home prices as other economic data remained robust. We soon caught

a glimpse of the potential ripple effect that declining home prices could have as a broad array of market participants such as hedge funds and banks began to reel as fundamentals deteriorated and liquidity dried up. Since the high on October 11, we have seen an 18% sell-off as the market digested the mounting risks in the current environment.



Source: Bloomberg

The market is painfully realizing that a retrenching in the housing market may not be as contained as first thought. The lending standards had become far too lax and tightening lending practices and less liquidity are now the dominant themes. The housing slowdown has snowballed into a larger credit crisis. This fear in the market has brought about a repricing of risk, not only in equities but across almost all asset classes.

THE HOUSING MARKET

The U.S. economy is undeniably at a crossroad. Economic data could easily lead investors to believe that a recession is at hand. Employment was the latest shoe to drop. Many of the last advocates of continued economic growth hung their hats on employment, hoping the consumer will continue to spend as long as the economy continues to add jobs and wage growth remains reasonable. The past two months have seen negative non-farm job growth and January provided the worst reading on the nonfarm payroll numbers since March of 2003. This pessimism and fear has been fueled by the media which has focused more attention on the housing market meltdown and the stock market sell-off, and rightfully so. This decline in the housing market may end up being the worst on record, and its impact is amplified by the unprecedented level of leverage involved. The Federal Reserve's calculation of homeowner's equity relative to home value fell to 48% in the fourth quarter of 2007. This is the lowest level since they began tracking the measure in 1951. However, a 48% reading is even more of a concern than the number suggests considering the changing demographics. Retirement-

age Americans account for a larger percentage of the population than ever before. Since this group has the most equity in their homes, this metric is facing some strong headwinds in the form of price declines that are still outpacing deleveraging

GOVERNMENT ACTION

The Federal Reserve is pulling out all of the stops to bolster the economy and the capital markets. They have lowered the discount window rate and the Federal Funds target rate from 5.75% to 3.50% and 5.25% to 2.25%, respectively. Only days after the Federal Reserve offered \$200 billion in emergency funds, they announced that they will pump \$280 billion in global markets to assist with liquidity. To say this announcement was welcomed by the markets would be an understatement. The S&P 500 enjoyed its best day since October 2002, which was the same month that the index formed the bottom before doubling in value over the next five years. However, the structure and goal of this liquidity injection were both questionable and concerning. The Federal Reserve offered to swap Treasuries with ordinary AAA-rated mortgage-backed securities as acceptable collateral. The market began to see this as a desperation move to aid the stock market or one or more troubled banks. This caused a financials-led market selloff that gave back all of the recent gains.

Congress also signed a \$152 billion fiscal stimulus package that will put \$600 into the hands of each individual, \$1200 to married couples, and \$300 for each dependent child. Even though this plan has its restrictions, it was devised to bolster one of the most important pieces of the US and global economic puzzles, the US consumer. Further spending proposals could be on tap as some Presidential candidates vow to use government funds to assist the working class through this crisis. As the federal budget deficit ballooned 60% in March, it is unclear how much more spending the government can withstand without raising tax rates. This budget strain is not welcomed, but is expected during times of financial crisis and consumer uncertainty. These stimulus programs by the government could eventually make the consumer more comfortable with spending, which would be well-received by the equity markets. Only time will tell the long-term impact that this will have on the economy and the stock market.

Inflation is yet another concern on the mind of investors. The Federal Reserve seems to have shifted more focus to maintaining growth rather than slowing inflation as they have lowered rates relentlessly in the past five months. The US dollar is trading at all-time lows against virtually every currency. Commodity prices have also soared since the Federal Reserve started its accommodative stance. Since the Federal Reserve first cut rates in September, natural gas is up 65%, crude oil is up 35%, gold is up 36%, and silver is 56%. During the same time, the trade-weighted dollar, which is a proxy of the international value of the US dollar, has depreciated by 8%.

THE NEW DEBATE

Equity market participants are clearly taking sides on a new debate. Investors are pondering whether this is a slowdown, recession, or something worse, rather than if we will experience a slowdown at all, which was the debate in 2007. As many economists and other market players forecast a greater than 50% chance of a recession, it is only fair to look back at past recessions and the equity market's behavior during these times. In the seven recessions since 1960, the S&P 500 lost

an average of 20.5% from peak to trough. These recessions lasted nine months on average. The National Bureau of Economic Research officially names the peaks and troughs of the economic cycle and, by default, tabs the beginning and ending of recessions and expansions. They have announced the past four recessions eight months into the recession on average. Being that economic data is backward-looking and the stock market is forward-looking, attempting to time the bottom of a recession is a very difficult game.

It is a fair statement to say that equities have begun to price in some recessionary concerns. The Volatility Index, shown in the graph below, shows the stock market volatility inherent in options market. The elevated option volatility shows that the market is less certain about stock returns, and heightened volatility coincides with market selloffs. The repricing of risk premiums across all asset classes due to concerns about credit, housing, inflation, and global growth continues. Stock valuations are historically cheap by most measures. Forward estimates do not offer much more solace than trailing estimates as evidenced by the recent string of negative preannouncements and the subsequent sell-off in stocks. Thus, we would expect the market to trade at a discount to forward and trailing valuations in this murky environment.



Source: Bloomberg

As the Fed model has proven to be an unreliable predictor of absolute or relative stock returns, another version of it could shed some light on the level of fear and anxiety priced into the stock market relative to Treasuries. The Fed Model compares the earnings yield with the yield on the 10-year Treasury. This spread represents the risk premium that is being applied to stocks compared to the 10-year Treasury note. However, as earnings estimates are at risk, the dividends provide a more reliable number which is more of a testament to the balance sheet risk inherent in the share prices. The risk to earnings going forward can be

reduced by replacing the earnings yield with the dividend yield. This approach, shown in the graph below, shows that the current spread between the two yields has not been this tight in 15 years, indicating that the markets are pricing in more of a risk premium than any other time in those years including the Long Term Capital Management collapse in 1998, the bursting of the tech bubble in 2000, and the ensuing recession.



Source: Bloomberg

As the debate rolls on and anxiety becomes more prevalent in the markets, we remain with our call that large-cap stocks will outperform as we believe that money flows should favor larger-cap, more liquid stocks. The near-term headline risk is still present, but the valuations and financial health of the market ex-financials should offer downside support. In our active funds, we have been buying on the dips as we feel that some of our holdings have sold off more than warranted.

International Equity Strategy

By Steve Lambdin

Most global economies continued to show signs of weakening in the fourth quarter of 2007. This put pressure on the global equity markets and most regions finished in the red for the quarter. Volatility remained very high as market peaks gave way to quick market downdrafts, as investors were very nervous regarding the global economic outlook. The U.S. Dollar continued to slide during the quarter, which helped very weak local market

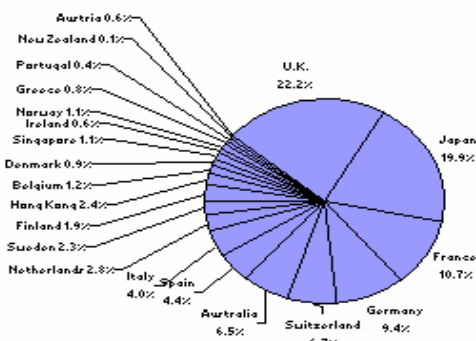
returns. Upheaval in the credit markets continued to put pressure on equity markets as well. Concerns surrounding the global consumer were at heightened levels in the quarter and seemed to be a major source of angst for most investors as confidence is slipping. Inflation is becoming a big concern around the globe, as most all commodities and energy prices continued to rise during the quarter, pushing many of these to record prices. Most eyes remain very fixed on the health of the U.S. economy, as the current "credit flu" continues to worsen. The global housing industry continued to remain an area of extreme weakness, as new starts and home prices have dropped considerably in many regions. Corporate earnings have begun to deteriorate very noticeably and should continue to do so over most of 2008. Central banks are attempting to provide aid to these troubled credit markets through continued monetary injections and interest rate cuts.

The MSCI EAFE Index (net dividend) declined -1.75% during the quarter vs. -3.33% for the S&P 500 Index. For all of 2007, the MSCI EAFE Index finished with a +11.2% return, well ahead of the +5.5% return of the S&P 500 Index. A falling U.S. Dollar provided the bulk of this outperformance. Within the MSCI EAFE Index, the European region outperformed the Asian region, as the Japanese equity market was very weak during the quarter. The best performing countries were Spain (+8.30%), Portugal (+7.40%), and Hong Kong (+7.10%), while Sweden (-12.80%), Ireland (-11.20%), and Japan (-6.10%) were the laggards during the quarter. From an economic sector standpoint, Energy and Materials were areas of strength, while Financials and Consumer Discretionary detracted from performance. During the fourth quarter, the U.S. Dollar fell approximately -3.75% vs. Euro and -2.84% vs. the Japanese Yen, while it rose 1.23% vs. the British Pound.

The table below shows the performance of each EAFE country's national indices broken down between local market return and the USD return during the fourth quarter of 2007.

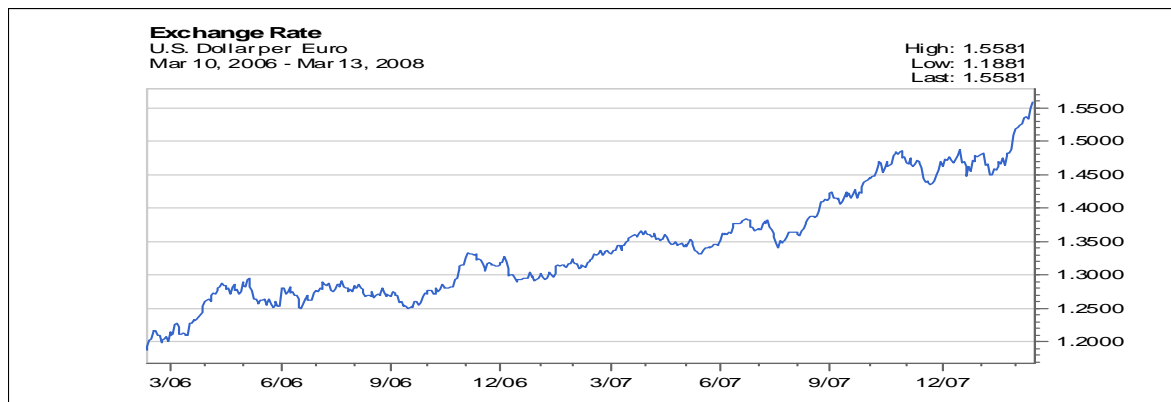
Country	Local Return	Curr Return	USD Return	EAFE Weight
United Kingdom	-0.10%	-2.30%	-2.40%	22.20%
Japan	-8.80%	2.70%	-6.10%	19.90%
France	-2.00%	2.70%	0.70%	10.70%
Germany	2.20%	2.90%	5.10%	9.40%
Switzerland	-5.00%	3.10%	-1.90%	6.70%
Australia	-3.40%	-0.80%	-4.20%	6.50%
Spain	5.30%	3.00%	8.30%	4.40%
Italy	-2.20%	2.70%	0.50%	4.00%
Netherlands	-4.40%	2.60%	-1.80%	2.80%
Hong Kong	7.50%	-0.40%	7.10%	2.40%
Sweden	-12.80%	0.00%	-12.80%	2.30%
Finland	-4.80%	2.70%	-2.10%	1.90%
Belgium	-8.50%	2.50%	-6.00%	1.20%
Singapore	-6.30%	2.90%	-3.40%	1.10%
Norway	-0.40%	-0.20%	-0.60%	1.10%
Denmark	-2.50%	2.70%	0.20%	0.90%
Greece	3.40%	2.90%	6.30%	0.80%
Ireland	-13.60%	2.40%	-11.20%	0.60%
Austria	-2.30%	2.80%	0.50%	0.60%
Portugal	4.50%	2.90%	7.40%	0.40%
New Zealand	-5.40%	1.70%	-3.70%	0.10%
EAFE	-3.00%	1.25%	-1.75%	100.00%

EAFE Country Weights as of December 31, 2007



Thus far in the first quarter of 2008, we have seen a dramatic fall off in most equity markets around the world. The chances of a recession in the U.S. have increased dramatically, putting significant pressure on world markets. From the end of December thru mid March, the MSCI EAFE Index (net dividend) and the S&P 500 Index are down approximately -9.1% and -9.8% respectively. Record high crude oil prices, even deeper credit concerns, a ramp up in inflation measures, a continued weakening global housing market, and a deteriorating employment outlook have pushed global equity markets into "bear market" territory. At this point, we just do not know how deep or long this period of economic weakness will last. This uncertainty makes equity markets nervous.

Presented below are some charts showing the movement of various currencies:

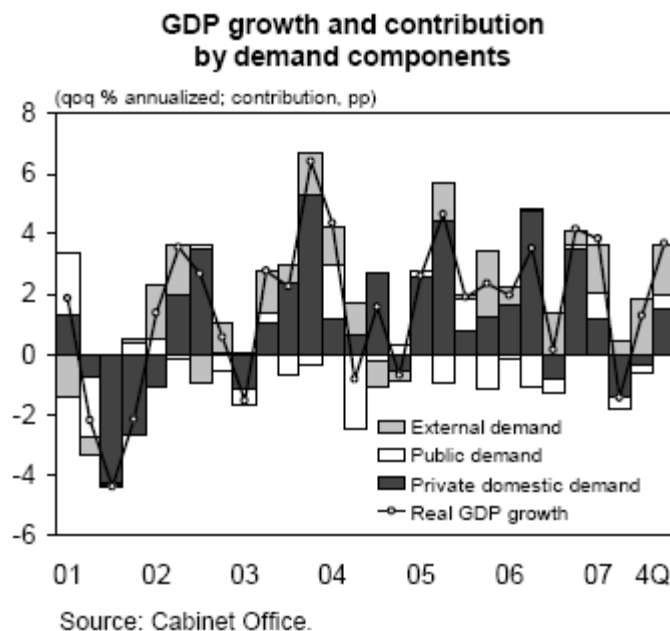


Japan Update

The equity market in Japan picked up from where it left off in the third quarter. Japan continued to be one of the worst performing markets within the MSCI EAFE Index. The Nikkei 225 Index fell by -8.8% in the fourth quarter of 2007 as political tensions ran high and concerns over Japan's export dependent economy came to the forefront. Havoc in the U.S. economy continues to put pressure on Japanese equity prices. A weakening U.S. Dollar did provide a bit of a buffer from these sharply negative returns. The consumer still remains a question mark in the Japanese economy. Economic data points still remain relatively weak and other Asian economies are not nearly as robust as they

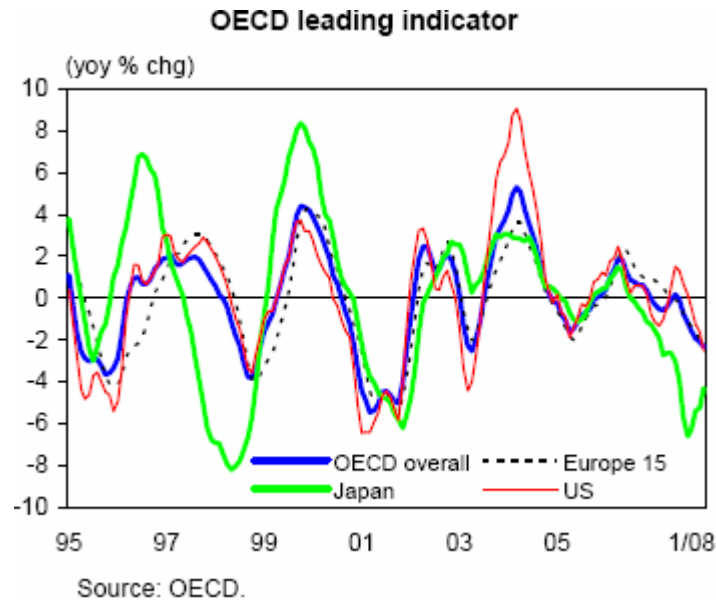
were just a couple of quarters ago. We still believe that for the Japanese economy to become stronger, things must get better in the U.S. With this in mind, we should continue to see a fairly weak equity market in Japan during the early part of 2008.

In a bit of a surprising twist, Japan reported fourth quarter GDP growth of +3.5% on a year over year basis. This is much better than the +2.3% that many economists had predicted. Though exports to the U.S. slipped due to the U.S. economic slowdown, exports to emerging markets rose at a healthy pace. Growth in exports to the “BRIC” (Brazil, Russia, India and China) countries continues to provide a buffer for a weak consumer. Even though consumer spending did pickup +0.2% from the previous quarter, this is still a very weak reading and could be a source of further weakness in early 2008 as recent consumer confidence surveys indicate a five year low in confidence. Housing investment still continues to fall, but not at the same severe pace we have seen earlier in the year. We still believe the U.S. slowdown is a major obstacle for the Japanese economy to overcome. We see evidence of this as Japan’s leading economic index fell to 30 percent in January, well below the 50 percent level, which usually signals a tough economic climate ahead. The recent move in the Japanese Yen vs. U.S. Dollar puts further competitive pressure on Japanese goods. This could lead to a tougher employment environment in 2008 for many workers. With these issues in mind, we would not be surprised to see Japan cut interest rates a bit from current levels in an attempt to stimulate its economy.



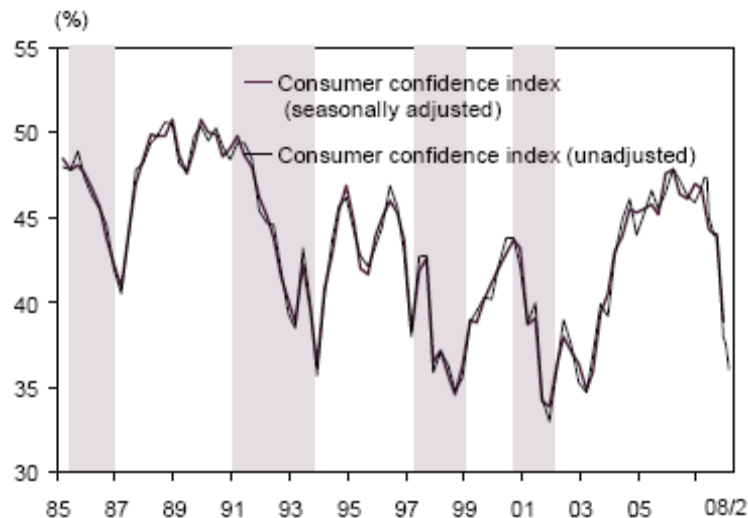
Industrial production in Japan for the fourth quarter rose approximately +1.3% from the year ago period. However, growth started off strong in October and continued to slip through the quarter. This was somewhat weaker than the third quarter, but seems to be in line with what we see happening in the global economy at the present time. We continue to hear reports of many companies slashing production schedules to match the current environment. As a result, profit margins will be under pressure. A weak export market will be tough to overcome in the near term. Growth in the Emerging Markets also will be slowing down from the healthy pace of 2007. Machinery orders fell in the fourth quarter from the third quarter as companies adjusted capital spending plans to the current

business climate. Though machinery orders can be erratic from month to month, we still believe the underlying trends point to further weakness in the early part of 2008.



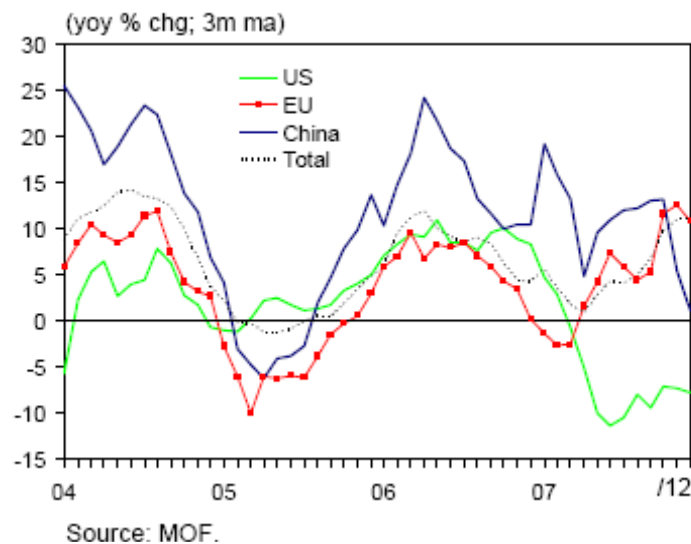
Rising food and energy prices are starting to affect consumer prices in Japan. In December, core consumer prices, which exclude food, rose +0.8% from the year ago period. Policy makers are concerned that oil and commodity prices could zap any potential strength from the consumer. This comes at a time when wage growth has stalled and consumer confidence is at a four-year low. We expected this to happen as rising energy and commodity prices are a global problem and not isolated to any one region. Many firms are attempting to raise prices to combat this rising input cost problem, which puts further pressure on consumers. On the employment front, the unemployment rate still hovered around the 3.8% level in the fourth quarter, which is still very structurally sound. However, the jobs-to-applicant ratio has slipped from 1.02 in October to .98 in December, a clear deceleration during the fourth quarter. Many companies have curtailed hiring plans in anticipation of a weakening economic climate in an attempt to defend against rising costs. This is just further evidence of a weakening business climate in Japan in early 2008.

Ex 2: Consumer Confidence Index (Long-term Series)



We continue to see a near-term tough outlook for the Japanese economy. Early 2008 economic data points have clearly weakened on the margin from an already weak late 2007 economic climate. The economy still faces the problems of higher input costs, a struggling consumer, and a clearly tougher export climate. Unfortunately, business conditions continue to deteriorate in the U.S., which is not a good sign for Japan's economy. As a result of this outlook, the Japanese equity market is down approximately -20% in 2008 on a local currency basis, significantly more than most other major equity markets around the world. This market is clearly in a "bear market." The key question at this point is just how bad will a recession be in the U.S. and how much of this will spread to other regions around the world? We feel the sooner investors can answer this question, the sooner we could see an equity market rally in Japan. Though most other Asian economies will slow down from the pace in 2007, they should do well relatively well vs. other regions of the world. From a valuation standpoint, Japanese equities look more attractive than a few months ago, but we see few catalysts over the near term to get them moving significantly upward. Investors remain very cautious in early 2008.

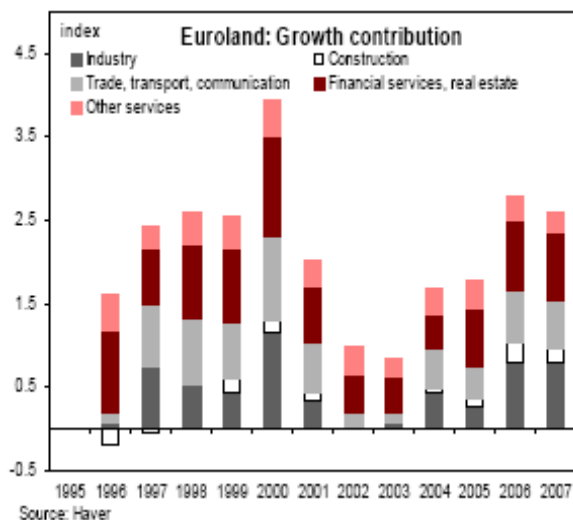
Export volume trends



Euroland Update

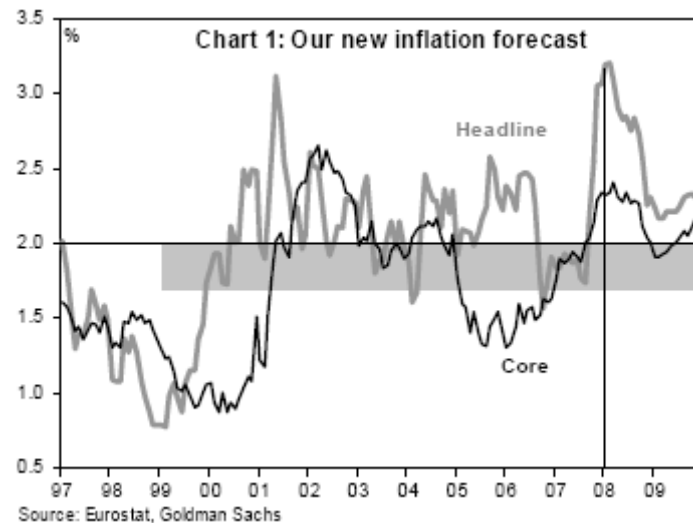
Euroland equity markets fared better than the U.K. and Japanese markets during the fourth quarter of 2007. The MSCI Europe region finished with a -0.4% USD return for the quarter and a +14.4% USD return for all of 2007. All in all, we feel this is not that bad in the face of many economic obstacles in 2007. The equity markets in Germany and Spain performed much better than we would have expected on the heels of some positive economic news. The European Central Bank (ECB) is playing the balancing act of fighting inflation while trying to maintain liquidity in the credit markets. The Euro continued to rise vs. the U.S. Dollar, which helped increase local market returns. However, we believe this region will not be immune to the weakness we see in other regions around the globe. As a result, we expect equity markets in Euroland to remain weak in early 2008 as this region tries to fight off a slowing economy.

In the fourth quarter of 2007 GDP rose +2.3% in the Euroland economy from the year ago period. Not surprisingly, this was below the levels seen in the third quarter. Exports were not at the levels seen in the previous quarter. The Euro's record rise against the U.S. Dollar continues to put pressure on this sector of the Euroland economy. Record crude oil prices and rising food costs continue to be an obstacle for this region and are pushing inflation to levels well above comfort for the ECB. As a result, consumer spending fell in the fourth quarter for the first time since 2001. This is indicative of what we have been seeing in other regions around the world. We see growth expectations for 2008 having to be cut due to the global slowdown we are seeing.



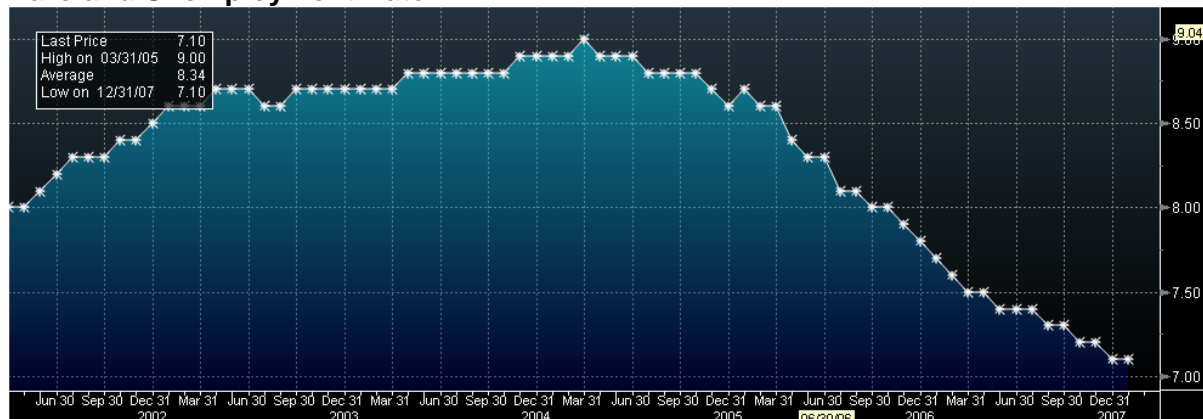
The ECB opted not to lower its main lending rate at its January, February, and March meetings. Its main lending rate remains at 4.00%. The ECB is sticking to its main purpose which is to promote price stability by keeping inflation rates down to an acceptable level of 2%. The ECB feels that its current monetary policies will eventually lead to lower inflation. Inflation has recently been reported at +3.2%, the highest level in almost nine years. A stronger Euro is helping to fight inflation, but making Euroland exports much less competitive in world markets. ECB Leader Trichet does feel the uncertainty with the region's main trading partners does present risk, but domestic demand looks structurally sound and has the ability to support some level of growth going forward. The ECB is also monitoring the current credit crisis and remains ready to take any measures necessary to maintain an orderly market, including coordinated efforts with

other central banks in order to stem any “crisis of confidence” that might develop. While we admire the ECB for its firm stance toward inflation, we believe growth going forward could be below their expectations, pushing a need for possible interest rate cuts. We see risk lying to the downside regarding economic data. With this in mind, our view is that the economic climate is tougher than the ECB’s current stance. We could see interest rate cuts over the next few months in an effort to promote more growth going forward and send the Euro down a bit vs. the U.S. Dollar.



The employment situation in the Euroland economies continues to surprise most investors. For the fourth quarter of 2007, the unemployment rate fell to 7.2% from 7.4% in the third quarter. This is at a new record low for the region. Past labor reforms continue to benefit Euroland's high structural unemployment rate. Progress on the labor front makes for a stronger Euroland economy, as domestic demand carries a greater emphasis than export demand. However, recent consumer and business confidence surveys point to potential weakening in the hiring environment. This could also put a damper on wage growth as we enter 2008.

Euroland Unemployment Rate

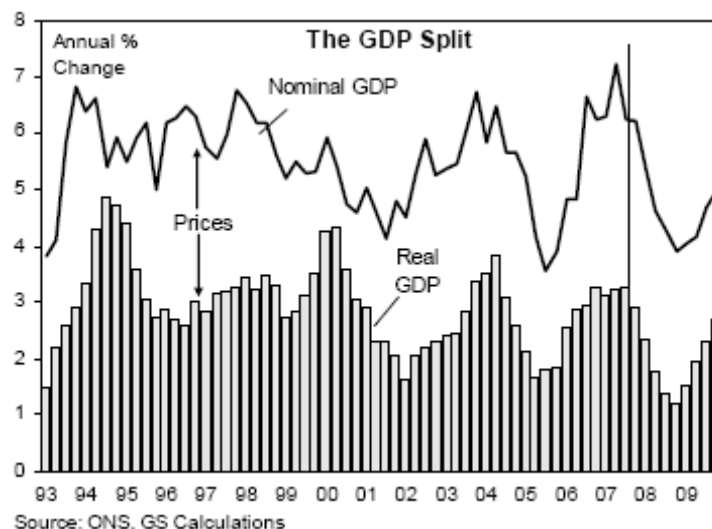


In summary, business conditions have deteriorated in the Euroland region a bit further than what we were anticipating a few months ago. The current recession fears spreading from the U.S. and Japan certainly cannot be taken too lightly. At this point, we just do not know how much of a slowdown we will see in this region. Economic growth expectations for 2008 continue to be reset with a downward bias. The Euro's rise against the U.S. Dollar still presents a major obstacle for the export driven economies in the region. However, emerging market demand has been more than we have expected thus far. As commodity, energy, and food prices continue to rise, the ECB's inflation worries will continue. As with every other region of the world, this can create a major headwind for an economy. As far as equity market valuations, Euroland stocks look very cheap relative to history. However, corporate earnings are being cut and economic data could surprise on the downside. With this in mind, equity markets across Euroland could firm up a bit and rally a bit from current levels, but a sustained uptrend does not seem very likely in the near term until the current credit crisis becomes more contained.

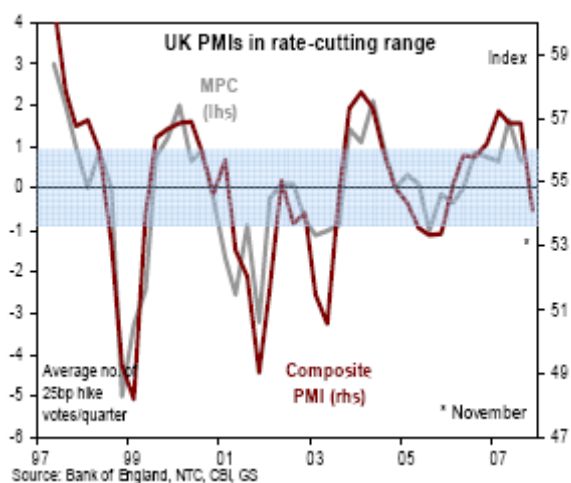
United Kingdom Update

The U.K equity market continued to flounder around without any clear direction during the fourth quarter. The local market return during the quarter was virtually flat vs. the third quarter, while the USD return was -2.40%, due to the U.S. Dollar's strength against the British Pound. Investors remain very cautious toward the U.K. equity market, as it has a relative large exposure to the financial services sector. The Bank of England (BOE) remains very focused on maintaining a very orderly and confident financial system in the face of the recent Northern Rock situation. Just as we have seen in other regions around the world, we believe the U.K. economy is slowing down. The severity of this downturn at this point in time is just not known. During the quarter, the British Pound did fall for the first time in recent memory vs. the U.S. Dollar on expectations that the BOE could be cutting interest rates in 2008.

The U.K. economy expanded at the slowest pace seen in a couple of years during the fourth quarter of 2007. Fourth quarter GDP rose +0.6% from the previous quarter, or +2.9% on a year over year basis. This was right in line with most economists' expectations. Record energy and food prices, coupled with rising credit costs, are all coming together to crimp the growth in consumer spending. Housing prices continue to drop as this slump is the worst in fifteen years. Mortgage lenders are seeing their profits drop and write downs in subprime mortgages have accelerated. Retail sales in December dropped off significantly to the lowest levels in almost a year, pointing to further evidence of a tough consumer outlook. While the services side of the economy continues to hold up surprisingly well, the manufacturing sector continues to struggle as input costs are rising quite dramatically. The strength of the British Pound makes it tough for exporters. We feel the key over the coming months will be how well the economy handles tighter credit conditions on business and consumer spending.

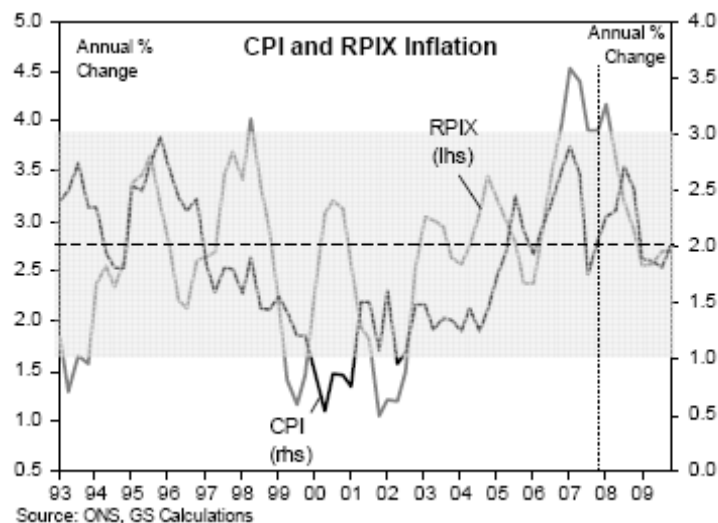


At its December policy meeting, the BOE opted to cut its key repurchase rate by 25 basis points to 5.50%. The Monetary Policy Committee (MPC) felt conditions in the financial markets had deteriorated very noticeably during the fourth quarter and presented a continued downside risk to the economy. With this decision, it seems like the MPC could be more focused on a slumping economy vs. its long standing fight against inflation concerns over the short term. This just shows how concerned the Monetary Policy Committee (MPC) is regarding inflation, as higher oil prices could send inflation above the committee's acceptable target level. After maintaining interest rates at its January meeting, the MPC then cut its key repurchase rate another 25 basis points to 5.25% at its February meeting. BOE Governor Mervyn King feels growth has continued to slowdown and the global credit crisis has intensified more than previously estimated. The MPC remains very concerned about the faltering U.S. economy and the effect this will have on its economy. The MPC is trying to keep interest costs at levels to spur business development. We feel these are the right actions to take in the face of a weakening global economy and also believe the MPC has a lot of room left to cut interest rates further in order to stimulate the U.K. economy. Clearly, economic risks in early 2008 lie to the downside. We expect economic data to come in weak, which should give the MPC ample opportunity to cut interest rates further in 2008.



In a piece of surprisingly good news, recent employment data have been fairly strong in the fourth quarter of 2007. Using ILO standards, the unemployment rate in the third quarter fell to 5.2%, down from 5.4% the previous quarter. This is in an environment where most other economic data points have been very weak. Jobless claims dropped in December to levels not seen since the mid 1970's, while total employment is at a record 29.4 million workers. During the quarter, wage growth remained in the +3.7% year over year range. However, we believe that improvement beyond these levels will be hard to obtain, as we see the current economic weakness beginning to put pressure on the labor force. This is already happening in other regions around the globe.

At this point in early 2008, we believe the U.K. economy will weaken to some degree, just as we are seeing in other economies. We believe that an outright recession in the U.K. will be avoided, as the service sector of the economy will hold up relatively well. Growth in the U.K. should be marginally better than what we will see in Euroland. With a large financial services side of the economy, we remain cautious surrounding the credit crises in the U.S. to see if this spreads to the U.K. We see housing data as continuing to weaken and the consumer probably will not be as strong in early 2008 as in previous periods. Inflation will be above targeted levels for most of 2008 as input costs have risen dramatically recently and the BOE focuses more on spurring economic activity with interest rate cuts. As has been the case, the manufacturing sector continues to have a dismal outlook due to a very strong British Pound. Valuations still look attractive in the U.K. equity markets, but with the current global slowdown, we see a rough equity market in the U.K. during the first quarter of 2008.



International Equity Activity/Strategy

The ratcheting down of global economic growth expectations continue to put a bit of pressure on global equity markets as we head into 2008. This is particularly painful for the export driven economies in Asia, which seem dependant on a strong U.S. consumer to fuel their growth. The U.S. subprime credit problems dominate the news flow, as this looks to continue to be a major problem in investors' minds. We are seeing this problem spread to other areas, creating many dislocations in the global credit markets. Inflation has begun to be a major headwind for investors to digest as we enter 2008. While the U.S. looks to continue to cut interest rates to stave off a recession, other regions have been more

reluctant to cut interest rates as aggressively as the U.S., fearing the inflationary aspects this strategy can bring on. The U.S. housing market continues to worsen and signs are this is spreading to other regions around the globe. Crude oil prices continue to move upward, and are now around the \$110 a barrel level. This is up significantly since the fourth quarter of 2007. Global unemployment looks set to rise from here as well, which should pressure consumer spending going forward. With these concerns in place, equity market prices have been under major pressure in early 2008, as volatility is quite high. As we look over the global landscape, we feel a recession in the U.S. is more of a factor than just a few months ago given that U.S. economic data continues to weaken. The odds probably favor a mild U.S. recession, which could push other regions around the world into one as well. Time will only tell us if this proves correct. While growth is even slowing down in the Emerging Markets, it still looks to be well above levels in the more developed regions and remains an attractive investment theme at present. Equity market valuations remain below historical levels and could stay this way for quite sometime as the economic slowdown concerns dominate the investing landscape.

Just as we reported in the previous quarter, we have not made any incremental investments into or out of our international equity portfolio since our last update. We continue to evaluate structured note equity product in the developed and emerging markets area for investment opportunities. We also continue to look at our options with the U.S. Dollar, but have been reluctant to move on anything in this area as we look for continued weakness near-term. As always, we will remain cautious and disciplined if we undertake any of these actions. Our total allocation to international equities is approximately 16% of total TRS and ERS assets and around 9% of the JRF total assets. Therefore, we expect to have a weighting to this asset class in the 15% to 18% range over the near term. *(Charts provided by Factset ,Goldman Sachs, ONS, Bloomberg, Bank of England, NTC, CBI, Haver, MOF, National Statistics Agency, Datastream, IDS, Eurostat, Cabinet Office, MIC, MHLW, OECD)*

TEACHERS RETIREMENT OF ALABAMA

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING January 31, 2008



STATE STREET.
For Everything You Invest In™

RATES OF RETURN - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>U.S. EQUITY</u>										
TRS CORE FUND	1,877,835,619	-5.91	-10.38	-5.91	-9.05	-1.27	7.53	12.82	3.96	Oct-94
TRS GOLDMAN SACHS GROUP INC	570,939,982	-3.03	-3.30	-3.03	-2.36	3.05				Aug-06
TRS S&P 500 FUND	4,790,074,708	-5.99	-10.53	-5.99	-9.11	-2.25	7.40	12.12	5.27	Oct-94
TRS S&P MID CAP INDEX	838,535,681	-6.21	-10.98	-6.21	-8.62	-2.09	8.92	15.41	10.74	Oct-94
TRS S&P SMALL CAP INDEX	401,505,683	-4.84	-12.63	-4.84	-10.98	-7.10	6.28	15.27		Mar-01
TRS SMALLCAP ACTIVE FUND	74,672,416	-4.33	-12.17	-4.33	-10.30	-6.02				Jun-06
TRS SPECIAL SITUATIONS	457,726,048	-4.11	-12.08	-4.11	-9.80	-4.48	9.74	14.43	7.48	Oct-94
TRS TOTAL DOMESTIC EQUITY	9,011,290,137	-5.66	-10.32	-5.66	-8.80	-2.10	7.69	12.92	5.45	Oct-91
TRS CUSTOM DOMESTIC EQUITY INDEX		-5.96	-10.74	-5.96	-9.18	-2.57	7.48	12.77		
S&P 500		-6.00	-10.55	-6.00	-9.13	-2.31	7.28	12.04	5.14	
S&P 400 MIDCAP		-6.16	-11.06	-6.16	-8.72	-2.23	8.89	15.41	10.71	
S&P 600 SMALL CAP		-4.89	-12.65	-4.89	-11.02	-7.09	6.35	15.69	8.70	
<u>INTERNATIONAL EQUITY</u>										
TRS ALLEGRO INVESTMENT CORP SA	76,969,622	-2.69	-2.40	-2.69	-0.31					Mar-07
TRS MORGAN STANLEY PLUS NOTES MSCI	78,838,900	-1.75	-0.29	-1.75	2.24					Mar-07
TRS I-SHARES EEM NOTE	33,840,640	-2.59	-4.53	-2.59	-3.36					Aug-07
TRS INTERNATIONAL EQUITIES	3,123,130,767	-9.10	-13.97	-9.10	-10.50	0.83	14.17	20.66	7.81	Nov-94
TRS TOTAL INTERNATIONAL EQUITY	3,312,779,929	-8.74	-13.37	-8.74	-9.95	1.62	14.47	20.85	7.89	Oct-94
MSCI EAFE (NET)		-9.24	-14.20	-9.24	-10.83	0.22	13.82	20.28	7.13	
TRS TOTAL GLOBAL EQUITY	12,324,070,065	-6.51	-11.16	-6.51	-9.11	-1.14	9.31	14.67	6.97	Oct-75
TRS CUSTOM GLOBAL EQUITY INDEX		-6.88	-11.69	-6.88	-9.62	-1.84	9.01			

TEACHERS RETIREMENT OF ALABAMA

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING January 31, 2008



STATE STREET.
For Everything You Invest In™

RATES OF RETURN - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>FIXED INCOME</u>										
TRS DOMESTIC FIXED INCOME	2,438,171,764	1.75	3.80	1.75	4.65	9.14	5.75	7.32		Aug-99
TRS CUSTOM DOMESTIC FIXED INDEX		1.59	3.36	1.59	4.33	8.23	4.56	5.02		
TRS TOTAL FIXED (ex. Private Placements)	2,438,171,764	1.75	3.80	1.75	4.65	9.14	5.74			Oct-03
TRS CUSTOM GLOBAL FIXED INDEX		1.59	3.36	1.59	4.33	8.23	4.53			
TRS PRIVATE PLACEMENTS	2,922,908,488	0.59	1.74	0.59	2.41	30.17	13.43	11.81		Aug-99
TRS CASH ACCOUNT	414,775,048	0.37	1.17	0.37	1.61	5.94	4.82			Sep-03
TRS TOTAL FIXED INCOME	5,775,855,300	1.10	2.65	1.10	3.39	19.15	9.37	9.36	7.52	Oct-93
<u>ALTERNATIVE INVESTMENTS</u>										
TRS PREFERRED STOCK	473,320,652	0.11	-0.25	0.11	-0.15	33.45	5.69			Sep-03
TRS REAL ESTATE	1,520,947,427	0.00	0.00	0.00	0.00	5.37	3.71			Oct-03
TRS INTERNALLY MANAGED	429,921,786	0.42	1.32	0.42	1.80	5.79	4.89			Oct-03
TRS OPTION COLLATERAL	5,720,000	0.00		0.00						Sep-03
TRS TOTAL ALTERNATIVES	2,429,909,865	0.13	0.28	0.13	0.42	9.23	4.14			Oct-03
TRS TOTAL F.I. PLUS ALTERNATIVES	8,205,765,165	0.78	1.88	0.78	2.43	16.02	7.79	8.07	6.88	Oct-93

TEACHERS RETIREMENT OF ALABAMA

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING January 31, 2008



STATE STREET.
For Everything You Invest In™

RATES OF RETURN - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>TOTAL PLAN</u>										
TRS TOTAL PLAN POLICY		-4.58	-7.91	-4.58	-6.26	-0.11	6.85			
TRS TOTAL PLAN	20,529,835,230	-3.71	-6.34	-3.71	-4.79	5.13	8.64	11.34	6.89	Oct-88

EMPLOYEE RETIREMENT OF ALABAMA

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING January 31, 2008



STATE STREET.
For Everything You Invest In™

SUMMARY OF PERFORMANCE - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>U.S. EQUITY</u>										
ERS CORE FUND	1,010,799,816	-5.91	-10.34	-5.91	-8.87	-0.94	7.63	12.82	3.94	Oct-94
ERS GOLDMAN SACHS GROUP INC	257,414,268	-3.03	-3.30	-3.03	-2.37	3.05				Aug-06
ERS S&P 500 FUND	2,176,189,477	-5.99	-10.53	-5.99	-9.11	-2.25	7.40	12.19	5.29	Oct-94
ERS S&P MID CAP INDEX	371,549,526	-6.19	-10.93	-6.19	-8.56	-2.04	8.93	15.44	10.77	Oct-94
ERS S&P SMALL CAP INDEX	165,122,607	-4.84	-12.62	-4.84	-10.98	-7.08	6.36	15.31		Mar-01
ERS SMALLCAP ACTIVE FUND	36,749,986	-4.31	-12.16	-4.31	-10.29	-6.01				Jun-06
ERS SPECIAL SITUATIONS	245,685,424	-4.12	-12.08	-4.12	-9.79	-4.45	9.92	14.54	7.45	Oct-94
ERS TOTAL DOMESTIC EQUITY	4,263,511,103	-5.66	-10.32	-5.66	-8.77	-2.02	7.71	12.96	5.48	Oct-93
<i>ERS CUSTOM DOMESTIC EQUITY INDEX</i>		-5.97	-10.73	-5.97	-9.17	-2.54	7.47	12.75		
<i>S&P 500</i>		-6.00	-10.55	-6.00	-9.13	-2.31	7.28	12.04	5.14	
<i>S&P 400 MIDCAP</i>		-6.16	-11.06	-6.16	-8.72	-2.23	8.89	15.41	10.71	
<i>S&P 600 SMALL CAP</i>		-4.89	-12.65	-4.89	-11.02	-7.09	6.35	15.69	8.70	
<u>INTERNATIONAL EQUITY</u>										
ERS ALLEGRO INVESTMENT CORP SA	36,761,644	-2.69	-2.40	-2.69	-0.31					Mar-07
ERS MORGAN STANLEY PLUS NOTES MSCI	37,654,400	-1.75	-0.29	-1.75	2.24					Mar-07
ERS I-SHARES EEM NOTE	18,242,220	-2.59	-4.53	-2.59	-3.36					Aug-07
ERS INTERNATIONAL EQUITIES	1,372,648,922	-9.10	-14.03	-9.10	-10.58	0.77	14.13	20.61	7.82	Nov-94
ERS TOTAL INTERNATIONAL EQUITY	1,465,307,186	-8.70	-13.36	-8.70	-9.97	1.64	14.45	20.82	7.91	Oct-94
<i>MSCI EAFE (NET)</i>		-9.24	-14.20	-9.24	-10.83	0.22	13.82	20.28	7.13	
ERS TOTAL GLOBAL EQUITY	5,728,818,289	-6.46	-11.12	-6.46	-9.07	-1.09	9.26	14.64	7.01	Oct-93
<i>ERS CUSTOM GLOBAL EQUITY INDEX</i>		-6.83	-11.65	-6.83	-9.59	-1.85	8.94			

EMPLOYEE RETIREMENT OF ALABAMA

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING January 31, 2008



STATE STREET.
For Everything You Invest In™

SUMMARY OF PERFORMANCE - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>FIXED INCOME</u>										
ERS DOMESTIC FIXED INCOME	1,128,367,935	1.79	3.87	1.79	4.73	9.25	5.71	7.39		Sep-99
ERS CUSTOM DOMESTIC FIXED INDEX		1.59	3.36	1.59	4.33	8.23	4.56	5.02		
ERS TOTAL FIXED (ex. Private Placements)	1,128,367,935	1.79	3.87	1.79	4.73	9.25	5.69			Oct-03
ERS CUSTOM GLOBAL FIXED INDEX		1.59	3.36	1.59	4.33	8.23	4.53			
ERS PRIVATE PLACEMENTS	1,430,173,531	0.61	1.73	0.61	2.39	30.76	13.55	11.59		Aug-99
ERS CASH ACCOUNT	179,669,154	0.36	1.17	0.36	1.60	5.95	4.91			Sep-03
ERS TOTAL FIXED INCOME	2,738,210,620	1.11	2.64	1.11	3.39	19.76	9.48	9.36	7.51	Oct-93
<u>ALTERNATIVE INVESTMENTS</u>										
ERS PREFERRED STOCK	439,171,562	0.07	-0.12	0.07	-0.08	34.67	7.47			Sep-03
ERS REAL ESTATE	740,948,160	0.00	0.00	0.00	0.00	5.49	3.71			Oct-03
ERS INTERNALLY MANAGED	126,120,960	0.43	1.32	0.43	1.80	5.77	4.90			Oct-03
ERS OPTION COLLATERAL	3,080,000	0.00		0.00						Sep-03
ERS TOTAL ALTERNATIVES	1,309,320,682	0.10	0.22	0.10	0.35	12.54	4.88			Oct-03
ERS TOTAL F.I. PLUS ALTERNATIVES	4,047,531,302	0.75	1.78	0.75	2.30	17.24	7.96	8.12	6.89	Oct-93

EMPLOYEE RETIREMENT OF ALABAMA

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING January 31, 2008



STATE STREET.
For Everything You Invest In™

SUMMARY OF PERFORMANCE - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>TOTAL PLAN</u>										
ERS TOTAL PLAN POLICY		-4.54	-7.84	-4.54	-6.22	-0.16	6.67			
ERS TOTAL PLAN	9,776,349,591	-3.58	-6.14	-3.58	-4.64	5.89	8.57	11.25	6.76	Oct-93

JUDICIAL RETIREMENT FUND

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING January 31, 2008



STATE STREET.
For Everything You Invest In™

SUMMARY OF PERFORMANCE - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>U.S. EQUITY</u>										
JRF S&P 500 FUND	123,251,160	-5.99	-10.53	-5.99	-9.11	-1.97	7.43	12.14	5.28	Oct-94
JRF S&P MID CAP INDEX	11,122,483	-6.56	-11.31	-6.56	-8.94	-2.43	8.88	15.47	10.77	Oct-94
JRF S&P SMALL CAP INDEX	3,616,694	-4.84	-12.64	-4.84	-11.01	-7.15	6.49	15.36		Mar-01
JRF TOTAL DOMESTIC EQUITY	137,990,336	-6.01	-10.65	-6.01	-9.15	-2.13	7.54	12.50	5.77	Oct-93
<i>JRS CUSTOM DOMESTIC EQUITY INDEX</i>		-5.98	-10.65	-5.98	-9.15	-2.45	7.39	12.41		
<i>S&P 500</i>		-6.00	-10.55	-6.00	-9.13	-2.31	7.28	12.04	5.14	
<i>S&P 400 MIDCAP</i>		-6.16	-11.06	-6.16	-8.72	-2.23	8.89	15.41	10.71	
<i>S&P 600 SMALL CAP</i>		-4.89	-12.65	-4.89	-11.02	-7.09	6.35	15.69	8.70	
<u>INTERNATIONAL EQUITY</u>										
JRF ALLEGRO INVESTMENT CORP SA	1,148,778	-2.69	-2.40	-2.69	-0.31					Mar-07
JRF MORGAN STANLEY PLUS NOTES MSCI	1,176,700	-1.75	-0.29	-1.75	2.24					Mar-07
JRF I-SHARES EEM NOTE	793,140	-2.59	-4.53	-2.59	-3.36					Aug-07
JRF INTERNATIONAL EQUITIES	19,008,182	-9.10	-13.97	-9.10	-10.51	1.01				Nov-06
JRF TOTAL INTERNATIONAL EQUITY	22,126,800	-8.20	-12.49	-8.20	-9.18	2.94				Nov-06
<i>MSCI EAFE (NET)</i>		-9.24	-14.20	-9.24	-10.83	0.22	13.82	20.28	7.13	
JRF TOTAL GLOBAL EQUITY	160,117,137	-6.32	-10.91	-6.32	-9.15	-1.51	7.84	12.70	5.86	Oct-93
<u>DOMESTIC FIXED INCOME</u>										
JRF DOMESTIC FIXED INCOME	52,834,634	1.61	3.52	1.61	4.40	8.60	5.80	7.29	5.28	Oct-93
<i>JRF CUSTOM DOMESTIC FIXED INDEX</i>		1.61	3.44	1.61	4.39	8.42	4.62	5.19		

JUDICIAL RETIREMENT FUND

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING January 31, 2008



STATE STREET.
For Everything You Invest In™

SUMMARY OF PERFORMANCE - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
JRF PRIVATE PLACEMENTS	9,178,829	1.09	0.54	1.09	1.39	21.42	18.88	13.95		Oct-01
JRF CASH ACCOUNT	11,180,033	0.37	1.18	0.37	1.61	5.21	4.58			Sep-03
JRF TOTAL FIXED INCOME	73,193,496	1.40	2.89	1.40	3.72	9.94	7.67	8.19	6.02	Oct-93
<u>ALTERNATIVE INVESTMENTS</u>										
JRF REAL ESTATE	2,526,996	0.00	0.00	0.00	0.00	4.66	3.85			Oct-03
JRS INTERNALLY MANAGED CASH	17,046,609	0.43	1.34	0.43	1.84	5.59	4.80			Oct-03
JRF TOTAL ALTERNATIVES	19,573,605	0.38	1.16	0.38	1.59	5.44	4.61			Oct-03
JRF TOTAL F.I. PLUS ALTERNATIVES	92,767,101	1.16	2.49	1.16	3.23	8.95	7.09	7.84	5.84	Oct-93
<u>TOTAL PLAN</u>										
JRF TOTAL PLAN	252,884,237	-3.69	-6.38	-3.69	-4.93	2.24	7.60	10.58	6.19	Oct-93
<i>JRF TOTAL PLAN POLICY</i>		<i>-4.16</i>	<i>-7.23</i>	<i>-4.16</i>	<i>-5.70</i>	<i>0.64</i>	<i>6.31</i>			